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In the Supreme Court of the United States

OCTOBER TERM, 1955

No. 84

SAN ANTONIO TRANSIT COMPANY, PETITIONER

v.

FRANK SCOFIELD, FORMERLY COLLECTOR OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The memorandum opinion (R. 121)[1] and findings of fact and conclusions of law (R. 122–133) of the district court are not reported. The opinion of the court of appeals (Pet. 47–59) and the opinion and dissenting opinion on petition for rehearing (Pet. 59–66) are reported at 219 F. 2d 149.

[1] The record in the instant case comprises two printed volumes, one entitled "Transcript of Record" and the other entitled "Exhibits" (which included the stipulation of facts and the district court's judgment). Record references herein labeled "R" will refer to the transcript of record, and those labeled "Supp. R" will refer to the exhibits volume.

JURISDICTION

The judgment of the court of appeals, reversing the district court's decision in favor of the taxpayer, was rendered on August 5, 1954. Taxpayer's petition for rehearing, seasonably filed, was denied on February 18, 1955 (Pet. 59). The petition for a writ of certiorari was filed May 17, 1955. The jurisdiction of this Court is invoked under 28 U. S. C., Section 1254.

QUESTIONS PRESENTED

The A corporation owned and operated eight separate buildings, each being of substantial value. In 1932, after the corporation was in financial difficulties, some of the creditors who held mortgage bonds on one of the buildings (the Tower Building) brought foreclosure proceedings and a receiver was appointed to operate the property. The remaining properties were operated by a nominee of other creditors until in May 1937 all seven other properties were transferred pursuant to foreclosure sale to corporation B in satisfaction of the claims of such other creditors. Shortly thereafter, in August 1937, the Tower Building was purchased at a foreclosure proceeding by the mortgage bondholders and transferred to corporation C, the taxpayer. The questions are:

1. Did the court below correctly hold that the taxpayer corporation was not entitled to use cor-

poration A's basis for the Tower Building under 1939 Code Section 113 (a) (7) on the ground that there was no "reorganization" under Section 112 (g) (1) (B) of the 1936 Act, for the reason that the taxpayer did not acquire substantially all the properties of corporation A or, alternatively, for the reason that there was on the facts of this case no continuity of the business enterprise?

2. Did the court below correctly hold that the taxpayer was not entitled to corporation A's basis for the Tower Building under Code Section 113 (a) (8) on the ground that corporation A was not the transferor of the property?

STATUTES AND REGULATIONS INVOLVED

The pertinent provisions of the statutes and Regulations, Sections 112 (a), (b) (4), (b) (5), and (g) (1) of the Revenue Act of 1936, Section 113 (a) (7) and (a) (8) of the Internal Revenue Code of 1939, and Article 112 (a)–1 of Treasury Regulations 94, promulgated under the Revenue Act of 1936, are set forth in the Appendix, *infra*, pp. 22–25.

STATEMENT

The court of appeals reversed (Pet. 59) the district court's judgment in favor of the taxpayer (Supp. R. 133A–133C).

The pertinent facts, as stipulated (Supp. R. 1–15) and appearing in the printed exhibits

(Supp. R. 15–265), and as set forth in the opinion of the court of appeals (Pet. 47–52), are summarized below:

Smith Brothers Properties Company, a Texas corporation (hereinafter called the old corporation), at the end of 1930, owned eight business properties in San Antonio, including the Smith-Young Tower Building (hereinafter called the Tower Building), which it built in 1928 at a cost of $2,070,709.09, financed by first mortgage bonds in the amount of $1,900,000 secured by a deed of trust. In addition, the old corporation owed considerable debts secured by various other indentures against its other properties (Pet. 47). In principal amount, taxpayer's total unpaid indebtedness at about this time totaled $4,295,500, consisting of $1,862,000 still owing on the Tower Building (Supp. R. 23), and $2,433,500 owing on the Plaza Hotel (R. 25), the A. B. Frank Building (R. 25–26), and on the remaining properties (R. 24–25).

On January 1, 1932, the old corporation defaulted on both the principal and interest payments then falling due on the Tower Building bonds (Pet. 48). On January 2, 1932, a protective committee for the Tower Building bondholders brought suit to foreclose the trust deed securing the bonds, to have a receiver appointed, and to have the Tower Building sold (Supp. R. 15–32). At that time, the unpaid principal and interest amounted to $1,905,137 (Supp. R.

23). A receiver was appointed; but this did not vest him with title to the Tower Building, which was still in the old corporation (Pet. 48).

In late 1932, or early 1933, the old corporation defaulted on its other secured debts, and all of its other properties were taken over by one Gill, agent for Massachusetts Mutual Life Insurance Company (hereinafter called Massachusetts), the holder of second and third mortgage notes against some of the properties. Gill was not judicially appointed, and the procedure employed by this group of creditors appears to have been entirely extra judicial at that time. At any rate, the properties were in the hands of the creditors and were operated by Gill separately from the Tower Building, which was then being operated by the receiver appointed in the trustees' foreclosure suit (Pet. 48).

Matters remained in substantially this condition from early 1933 until 1937 (Pet. 48–49).

After an earlier proposed plan of reorganization (Supp. R. 39–44), submitted to the Tower Building bondholders in November, 1932, had been abandoned, the protective committee for Tower bondholders, on October 29, 1936, worked out an agreement with Dallas Rupe & Son, Inc. (hereinafter called Rupe), whereby that investment company agreed to furnish the funds necessary to facilitate the adoption of a new proposed plan of reorganization (Supp. R. 44–78). Under the plan, Rupe furnished the protective commit-

tee with funds to purchase the bonds of nonparticipating Tower Building bondholders. In return, Rupe was to receive covering voting trust certificates for shares in a new company to which the nonparticipating Tower bondholders would have been entitled. In addition, Rupe was to receive certificates covering three percent of the shares to be issued to participating bondholders, including Rupe. Under the plan, participating bondholders were to receive voting trust certificates representing one share of the contemplated corporation's common for each $100 principal amount of bonds surrendered. Rupe also agreed to negotiate a loan to the new corporation for $100,000, to be secured by a first mortgage on the Tower Building (Pet. 49–50).

Meanwhile, independent of the Tower bondholders' negotiations, described above, a group of creditors, which had acquired the old corporation's common stock, organized Century Investment Company (hereinafter called Century), a Texas corporation (R. 29). On April 1, 1937, Century acquired all the assets of Smith Brothers' estate[2] (R. 30), including a majority of the common stock of the old corporation. It also purchased all the defaulted secured obligations then held by Massachusetts. Thereafter, Century filed a foreclosure suit against the old cor-

[2] This is the partnership to which the original shareholders of Smith Brothers Properties Company had assigned their common stock in trust (R. 27).

poration on the properties securing these obligations, the suit constituting a completely separate judicial action from the one previously brought by the trustees of the Tower Building deed of trust. Pursuant to a previously arranged plan, all of the properties, other than the Tower Building, were purchased at Century's foreclosure sale by Plaza Company, which was created by Century for that particular purpose. The old corporation had no equity in the properties so sold, and it executed a quitclaim deed to Plaza Company for all the properties thus purchased. This was accomplished on May 4, 1937 (Pet. 49).

Prior to the above described foreclosure sale of May 4, 1937, the Tower bondholders' protective committee, on April 29, 1937, intervened in the pending foreclosure against the Tower Building, setting forth the plan (R. 36). The committee also agreed to assign all deficiency claims for the balance of principal and interest on the old bonds after the foreclosure to the old corporation and the latter, in turn, agreed to withdraw all defenses to foreclosure proceedings (Pet. 50).

On May 27, 1937, the court approved the plan and ordered the sale of the Tower Building by the receiver appointed in 1933 and it was bid in by a nominee of the protective committee at foreclosure sale on August 3, 1937, for $335,160. This sale was confirmed on August 27, following; and, on August 31, 1937, the receiver conveyed

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the property, including building, lot, personal property, and accounts receivable up to July 31, 1937, to Smith-Young Tower Corporation,[3] the taxpayer herein (Pet. 50).

On August 31, 1937, the price bid by the committee's nominee was paid by the receiver by delivery of $1,667,000 face value of Tower Building bonds for a credit of $300,060, and the balance of the bid, or $35,100, was paid by the committee with cash received from Rupe under the agreement. At that time, taxpayer issued 18,620 shares of its voting stock to voting trustees in consideration of all property conveyed to it. The trustees, in turn, issued stock to the Tower Building bondholders at the agreed rate of one share for each $100 in principal amount of bonds surrendered—16,970 shares to all participating bondholders and 1,650 shares to Rupe for bonds purchased from nonparticipants. Later, Rupe received 558 additional shares, amounting to three percent of the entire issue to participating bondholders, in accordance with the agreement (Pet. 50–51).

In determining depreciation and equity invested capital for purposes of its income and excess profits taxes for the fiscal year ending May 31, 1943, taxpayer used the same adjusted basis for the Tower Building as had been used by Smith

[3] Later, on December 14, 1942, taxpayer's name was changed, by charter amendment, to San Antonio Transit Company (R. 130).

Brothers Properties Company. The Commissioner used the fair market value on August 31, 1937, the date taxpayer acquired title, and, since this was a much lower figure, assessed deficiencies. Taxpayer paid the taxes as assessed and brought this suit to recover, alleging that it acquired the Tower Building as a result of a nontaxable reorganization under the applicable provisions of the Revenue Act of 1936, and, alternatively, contending that the transaction of acquisition constituted a nontaxable exchange under Section 112 (b) (5) of the 1936 Act, and that this entitled it to a carryover of the old corporation's basis under Section 113 (a) (8) of the Internal Revenue Code of 1939. (Pet. 51–52.)

ARGUMENT

This case presents no question calling for review by this Court. In rejecting petitioner's contention that it acquired the property in a nontaxable reorganization, the court below correctly applied established principles, and there is no conflict of decisions. The ruling of the court below on petitioner's alternative argument, based on Sections 112 (b) (5) of the 1936 Act and 113 (a) (8) of the 1939 Code, is one of first impression and is likewise correct. Moreover, since the latter question has been largely mooted by legislation, it is not one of general importance.

1. Under 1939 Code Section 113 (a) (7) (B) (App., pp. 23–24), a taxpayer is entitled to use, in

calculating its income and excess profits tax, the basis of a predecessor corporation, where all the requirements of a nontaxable "reorganization" are met. "Reorganization," as defined in the statute, includes "the acquisition by one corporation in exchange solely for all or a part of its voting stock * * * of substantially all the properties of another corporation, * * *" (Sec. 112 (g) (1) (B) Revenue Act of 1936 (App., pp. 22–23)). The decisions and the applicable regulations make it clear that to qualify as such a "reorganization" there must also be a "continuity of the business enterprise." Treasury Regulations 111, Section 29.112 (g)–1. The court below correctly concluded that the transaction herein failed to qualify as a "reorganization" because (a) taxpayer did not acquire "substantially all of the properties" of the predecessor corporation and, alternatively, (b) because taxpayer failed to establish that the requisite continuity of interest existed. The court below did not pass on the question whether the transaction failed to qualify for the additional reason that taxpayer had not acquired the property of the transferor "solely" for voting stock[4] (Pet. 54).

(a) Taxpayer's contention (Pet. 23–27) that the court below was precluded from looking

[4] Petitioners' hypothetical contention (Pet. 27–29) that *if* the court had decided this question adversely to taxpayer, "it would be in conflict with other decisions," plainly is not a reason supporting the grant of certiorari in this case.

beyond the facts existing on "the date when the reorganization was actually effected" (Pet. 24) in determining whether taxpayer acquired "substantially all the properties of another corporation" is without merit. Petitioner argues that since on August 31, 1937, the bulk of the properties of the predecessor corporation had already been sold, it on that date literally succeeded to all the remaining properties of the original corporation. True, but this literal contention ignores the realities of the situation; the predecessor corporation owned and managed eight different business properties, of which the Smith-Young Tower Building was only one; the other seven properties had been disposed of just four months previously. As the court below correctly observed: "Under no reasonable view can it be said that * * * substantially all of [the old corporation's] property was transferred to [taxpayer]" (Pet. 57). Taxpayer succeeded to only one fragment of the old business.

The statutory requirements deal with realities; they never have been construed to operate in the artificial manner urged by taxpayer. Other courts, like the court below, have applied the statute in the context of the entire factual setting and not merely with regard to the situation as it existed at the moment of any particular transfer. *Helvering* v. *Elkhorn Coal Co.*, 95 F. 2d 732 (C. A. 4th), certiorari denied, 305 U. S. 605; *Mellon* v. *Commissioner*, 12 T. C. 90, 108–109, affirmed,

184 F. 2d 157 (C. A. 3d); *Reilly Oil Co.* v. *Commissioner*, 13 T. C. 919, 926, affirmed on other grounds, 189 F. 2d 382 (C. A. 5th). The Congressional purpose requiring that "substantially all the properties" of the transferor corporation be acquired by the transferee corporation in order to qualify as a tax-free "reorganization" would be stultified under the taxpayer's view of the statute. Congress plainly did not intend that several different transferees should each be regarded as having acquired substantially all the property of a single corporation where the successive transfers are in such a sequence that each consists of a substantial part of the property *then* owned by the transferor. Nor would it be reasonable for the courts to invent, as petitioner urges, a rule which would permit a taxpayer corporation which acquired say 20 percent of a corporation's assets to use the transferor's basis if those assets, as here, were acquired *after* the greater portion of its assets had been transferred to others, but would forbid the use of the transferor's basis where those assets were acquired *before* the bulk of the transferor's assets had been transferred to others.

The cases relied on by petitioner (Pet. 24–27) are distinguishable. In *Helvering* v. *Southwest Corp.*, 315 U. S. 194, 201, this Court held that in considering whether the requirement that assets be acquired "solely for * * * voting stock" was met, the Court could not ignore the fact that in that case warrants also had been issued. The

Court was not impressed by taxpayer's argument that in the long run the unexercised warrants all would expire, leaving only voting stock outstanding. As the Court said: " 'Solely' leaves no leeway. Voting stock plus some other consideration does not meet the statutory requirement" (*id.* at 198). The warrants are "no different than if other convertible securities had been issued, all of which had been converted within the conversion period" (*id.* at 201). The Court's comment, in this context, that the "critical time is the date of the exchange" (*ibid.*; Pet. 24), plainly lays down no rule to the effect that it is error to look to the entire transaction in determining whether a transferee corporation has acquired "substantially all the properties" of another corporation.[5]

[5] The courts of appeals cases cited by petitioner similarly deal with statutory provisions other than those involved in this case (Pet. 24–25). *Thurber* v. *Commissioner*, 84 F. 2d 815 (C. A. 1st), involved the question whether a reorganization in the form of a merger had occurred, where prior to the alleged merger the corporation had distributed some of its assets to its shareholders. *Commissioner* v. *Carman*, 189 F. 2d 363 (C. A. 2d), involved the question whether certain payments made after the effective date were made "in pursuance of the plan of reorganization", as required by Sections 112 (b) (3) and (c) (1), of the 1939 Code. The trial court's decision in *American Foundation Co.* v. *United States*, 120 F. 2d 807 (C. A. 9th), was reversed on the Government's confession of error. The language quoted in the petition (Pet. 25) is from the Government's motion, not the court's opinion. When read in context, it merely recites that in determining "whether substantially all the properties" have been transferred, the proper computation is to compare, not orginal costs, but the value, as of the date of the transfer, of the property transferred and the property retained.

In *Peabody Hotel Co.* v. *Commissioner,* 7 T. C. 600, the Tax Court held that a corporation which succeeded to 87 percent of the assets of the transferor corporation, including all the assets to which the corporation's general creditors could look for payment of their claims, had acquired "substantially all the properties" of the transferor corporation within the meaning of the statutory requirement. The case does not suggest, as taxpayer seems to imply (Pet. 25–27), that the transferee of the remaining property, consisting of 13 percent of the transferor's assets, which in fact were transferred to another corporation on the same day, could also be said to have acquired "substantially all of the property" of the transferor corporation.

(b) Taxpayer misconceives what the court below decided when it held, alternatively, that the requisite continuity of interest was lacking in this case. Taxpayer urges (Pet. 21) that the court ruled that in order to meet this test taxpayer was "required to take over the entire business of Smith Brothers Properties Company as it existed in 1932 or 1933." This assumption as to the scope of the decision, which forms the basis of petitioner's discussion of continuity of interest, may be contrasted with what the court actually held (Pet. 57):

> We do not base our conclusion here on any calculation of the percentage of the old corporation's property transferred to the

taxpayer. Nor do we hold that it is necessary for all or any particular number of the old creditors to become stockholders in the new corporation. We simply hold that in this case, where the taxpayer acquired what amounts to only one property of a substantial enterprise as a result of proceedings and activities completely separate from all other property and from the claims of all other creditors, the necessary continuity of interest is not shown. Under no reasonable view can it be said that the old corporation has emerged as substantially the same enterprise in new form or that substantially all of its property was transferred to the new corporation.

The decision thus represents the application of well established principles[6] to the peculiar circumstances of this case. We believe that the court of appeals correctly applied those principles in holding that when the taxpayer acquired a relatively small portion of the old corporation's assets remaining after the most substantial part

[6] *Pinellas Ice Co.* v. *Commissioner*, 287 U. S. 462; *Helvering* v. *Minnesota Tea Co.*, 296 U. S. 378; *LeTulle* v. *Scofield*, 308 U. S. 415, rehearing denied, 309 U. S. 694; *Helvering* v. *Limestone Co.*, 315 U. S. 179; *Palm Springs Corp.* v. *Commissioner*, 315 U. S. 185; *Bondholders Committee* v. *Commissioner*, 315 U. S. 189; *Helvering* v. *Southwest Corp.*, 315 U. S. 194; Sec. 29.112 (g)–1, Treasury Regulations 111, promulgated under the Internal Revenue Code of 1939, and comparable provisions of prior Regulations beginning with Art. 112 (g)–1, Treasury Regulations 86, promulgated under the Revenue Act of 1934.

of its properties and business, including a majority of its common stock, had been transferred to another corporation, there was no "continuity of the business enterprise"[7] conducted by the old corporation.

Of course, since, as noted above, the reorganization fails to qualify for another independent reason, the ruling of the court of appeals with respect to lack of continuity of interest would not, even if the correctness of the decision below was less clear, call for review by this Court.

2. As an independent, alternative ground supporting the trial court's ruling, the taxpayer contended below that it had acquired the property in a nontaxable exchange under Section 112 (b) (5) of the 1936 Act (App., p. 22); that the old corporation was the transferor of the property; and that, accordingly, under Code Section 113 (a) (8) (App., pp. 23–24), it was entitled to use the old corporation's basis. The trial court did not pass on these contentions (see Pet. 58). Petitioner argues (Pet. 30–45) that the rulings of the court of appeals on this branch of the case support the grant of certiorari.

The court below, although it expressed doubt as to whether Section 112 (b) (5) was applicable, explicitly refrained from deciding whether that section in fact applied (Pet. 58, 59). Petitioner's contentions (Pet. 30–37) as to the applicability of

[7] Sec. 29.112 (g)–1, Treasury Regulations 111, fn. 5, *supra*.

Section 112 (b) (5) are therefore beside the point; accordingly, we refrain from discussing Section 112 (b) (5) except to express our view that, had the decision been that the section had no applicability to the particular circumstances of this case, it would have been correct and not in conflict with any other decision.

The court below assumed, without deciding, that Section 112 (b) (5) was applicable. But it held that even if this were the case, "we could not affirm the judgment, for the plain language of 113 (a) (8) requires the transferee corporation to use the basis of its *transferor.*" Pointing to the fact that the bondholders had completely displaced the stockholders long before and had operated the property through a receiver appointed in their foreclosure proceeding for a period of five years before the transfer to the taxpayer, the court of appeals concluded that the old corporation could not be regarded as the transferor whose basis becomes that of the transferee under Section 113 (a) (8). It concluded that the bondholders were the transferors and that "their basis, not the old corporation's, would apply." (Pet. 58–59). Contrary to the taxpayer's contentions (Pet. 38–45), we submit that the decision is correct and is not in conflict with this Court's decisions or with the decisions of any other court.

The court below based its conclusion that the old corporation was not the transferor of the property acquired by the taxpayer on this Court's

decision in *Helvering* v. *Cement Investors,* 316 U. S. 527. While the *Cement Investors* case did not involve a basis question, we believe that the decision below fairly reflects the essential rationale of that case. The issue there was whether creditors of a corporation which was reorganized under Section 77B of the Bankruptcy Act, c. 541, 30 Stat. 544, sustained gain when they acquired stock and securities in the reorganized company. This Court held that there was a nontaxable transaction under Section 112 (b) (5) of the Revenue Act of 1936. In so holding, this Court rejected the Government's contentions that that section, which applies to "property * * * transferred to a corporation by one or more persons" was inapplicable because the property was transferred by the debtor corporation, the bankruptcy trustee and the indenture trustee, and because the creditors did not transfer any property. Instead, the Court considered (*id.* at 532) that the creditors had acquired an "equitable interest" in the debtor corporation's property, that Section 112 (b) (5) includes such an interest in property, and "we see no reason to conclude that a beneficial owner of, or equitable claimant to, property is precluded from consummating an exchange which qualifies under § 112 (b) (5) * * *."

As this Court noted in the *Cement Investors* case (*id.* at 534): "If a transaction meets the requirements of § 112 (b) (5), the basis of the property in the hands of the acquiring corpora-

tion is the same as it would be in the hands of the transferor. § 113 (a) (8)." Since *Cement Investors* regarded the bondholders as transferors of property for the purposes of Section 112 (b) (5), it seems a fair application of the ruling of that case to consider that they are also the transferors to whose basis the transferee succeeds under Section 113 (a) (8). That conclusion seems particularly appropriate here where the creditors had obtained the appointment of a receiver who operated the property for their benefit for a period of some five years prior to the ultimate acquisition by the taxpayer, and where the old corporation had lost any substantial interest in the property long before the transfer in question.

Even if there were more serious doubts concerning the correctness of the decision below, the question presented would not call for review by this Court. The ruling of this case is one of first impression. It rests essentially on the facts of this case and does not necessarily govern every insolvency reorganization. Furthermore, the question whether the creditors may be the transferors, not only for purposes of Section 112 (b) (5), as was held in *Cement Investors,* but also for purposes of Section 113 (a) (8), as was held by the court below, has been largely mooted by Section 121 of the Revenue Act of 1943, c. 63, 58 Stat. 21, which added to the 1939 Code Section 112 (b) (10) and (l), and, in addition to making suitable amendments to other basis provisions,

added Section 113 (a) (22). The net effect of those amendments, which were made effective for taxable years beginning after December 31, 1933, but were not to affect tax liabilities for taxable years beginning prior to January 1, 1943,[8] is that if property is transferred in a receivership, foreclosure or similar proceeding or under Section 77B or Chapter X of the Bankruptcy Act to another corporation to effectuate a court approved plan of reorganization and the transfer is in exchange solely for stock or securities, no gain or loss is recognized to the corporation or the exchanging security holders. Section 113 (a) (22) explicitly provides that in the event of such an acquisition the basis of the acquiring corporation shall be the same as it would be "in the hands of the corporation whose property was so acquired." As a consequence, where those provisions (which were adopted to resolve the remaining doubts and uncertainties which resulted from existing law) are applicable, the new corporation succeeds to the old corporation's basis and it thus becomes immaterial whether the creditors of the old corporation would be regarded as the transferors under Sections 112 (b) (5) and 113 (a) (8). See S. Rep. No. 627, 78th Cong., 1st Sess., pp. 49–53 (1944 Cum. Bull. 973, 1010–1012). These statutory provisions, which have also been incorporated in Sections 371 and 372 of the Inter-

[8] The taxable year in controversy here began on June 1, 1942, and ended on May 31, 1943. (Pet. 51.)

nal Revenue Code of 1954, negate the taxpayer's assertion that the decision here raises an important question which should be reviewed by this Court.

CONCLUSION

For the reasons stated, the petition for a writ of certiorari should be denied.

Respectfully submitted,

SIMON E. SOBELOFF,
Solicitor General.
H. BRIAN HOLLAND,
Assistant Attorney General.
ELLIS N. SLACK,
HILBERT P. ZARKY,
DAVIS W. MORTON, Jr.,
Special Assistants to the Attorney General.

JULY 1955.

APPENDIX

Revenue Act of 1936, c. 690, 49 Stat. 1648:

SEC. 112. RECOGNITION OF GAIN OR LOSS.

(a) *General Rule.*—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

(b) *Exchanges Solely in Kind.*—

* * * * *

(4) *Same—Gain of corporation.*—No gain or loss shall be recognized if a corporation a party to a reorganization exchanges property, in pursuance of the plan of reorganization, solely for stock or securities in another corporation a party to the reorganization.

(5) *Transfer to corporation controlled by transferor.*—No gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock or securities in such corporation, and immediately after the exchange such person or persons are in control of the corporation; but in the case of an exchange by two or more persons this paragraph shall apply only if the amount of the stock and securities received by each is substantially in proportion to his interest in the property prior to the exchange.

* * * * *

(g) *Definition of Reorganization.*—As used in this section and section 113—

(1) The term "reorganization" means (A) a statutory merger or consolidation,

or (B) the acquisition by one corporation in exchange solely for all or a part of its voting stock: of at least 80 percentum of the voting stock and at least 80 percentum of the total number of shares of all other classes of stock of another corporation; or of substantially all the properties of another corporation, or (C) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, or (D) a recapitalization, or (E) a mere change in identity, form, or place of organization, however effected.

* * * * *

Internal Revenue Code of 1939:

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) Basis (Unadjusted) of Property.—The basis of property shall be the cost of such property; except that—

* * * * *

(7) *Transfers to corporation.*—If the property was acquired—

(A) after December 31, 1917, and in a taxable year beginning before January 1, 1936, by a corporation in connection with a reorganization, and immediately after the transfer an interest or control in such property of 50 per centum or more remained in the same persons or any of them, or

(B) in a taxable year beginning after December 31, 1935, by a corporation in connection with a reorganization,

then the basis shall be the same as it would be in the hands of the transferor, increased

in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made. This paragraph shall not apply if the property acquired consists of stock or securities in a corporation a party to the reorganization, unless acquired by the issuance of stock or securities of the transferee as the consideration in whole or in part for the transfer.

(8) *Property acquired by issuance of stock or as paid-in surplus.*—If the property was acquired after December 31, 1920, by a corporation—

(A) by the issuance of its stock or securities in connection with a transaction described in section 112 (b) (5) (including, also, cases where part of the consideration for the transfer of such property to the corporation was property or money, in addition to such stock or securities), or

(B) as paid-in surplus or as a contribution to capital,

then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made.

* * * * *

(26 U. S. C. 1952 ed., Sec. 113.)

Treasury Regulations 94, promulgated under the Revenue Act of 1936:

ART. 112 (a)–1. *Sales or exchanges.*—The extent to which the amount of gain or loss, determined under section 111, from the sale or exchange of property is to be

recognized is governed by the provisions of section 112. The general rule is that the entire amount of such gain or loss is to be recognized.

An exception to the general rule is made by section 112 (b) (1) to (5), inclusive, in the case of certain specifically described exchanges of property in which at the time of the exchange particular differences exist between the property parted with and the property acquired, but such differences are more formal than substantial. As to these, the Act provides that such differences shall not be deemed controlling, and that gain or loss shall not be recognized at the time of the exchange. The underlying assumption of these exceptions is that the new property is substantially a continuation of the old investment still unliquidated; and, in the case of reorganizations, that the new enterprise, the new corporate structure, and the new property are substantially continuations of the old still unliquidated.

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